

A Global Currency Crisis in 2026?

Let me start with an “AI” summary of the article, since that’s the most likely step for readers.

- I. The US Federal Reserve, through its ultra-loose monetary policies, has inflated a series of asset bubbles - AI Bubble, Housing Bubble (HB) 2.0, and the Bond Bubble – and the bursting of these bubbles is very likely to start in 2026.
- II. The bursting of the asset bubbles would push the US Economy into an Inflationary Depression that would eventually be called “The Greater Depression”. Price inflation will be higher than the US experience during the stagflationary 1970s (near 15% at its peak), while the contraction in GDP will rival that of “The Great Depression” of 1929 to 1946.
- III. Notwithstanding the similarities to the 2008 GFC (Global Financial Crisis) in terms of the underlying causative factors and the response of the US Government/Federal Reserve to the bubbles bursting, the eventual outcomes in terms of the impact on the US Economy as well as the US Dollar would be vastly different. The US Dollar is likely to substantially weaken not only against Gold but also against other currencies.

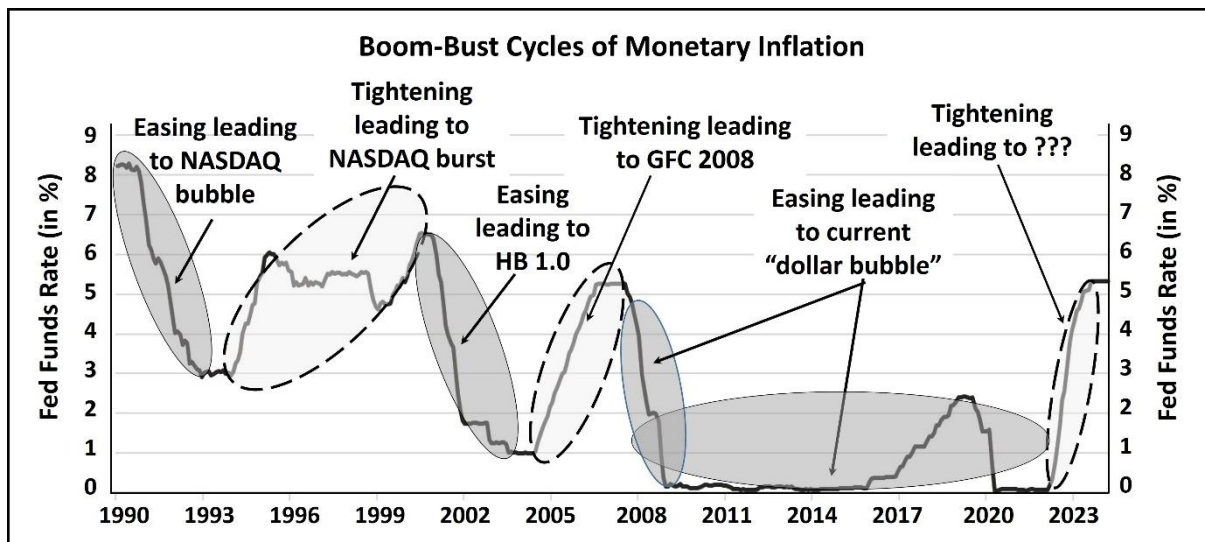
The bubbles referred to above have been in the making for quite a few years now – perhaps even more than a decade. The fact that the bubbles have grown bigger (e.g., HB2.0 as compared to HB1.0 leading up to 2008), newer bubbles (the AI / MAG7) have been inflated, and the stock markets have chugged along steadily without any meaningful correction has only lulled investors into a deep slumber. Perhaps even closer to the stage of coma, as far as the perception of risk is concerned. FDR’s quote, “**the only thing to fear is fear itself**,” that he made at the very depth of The Great Depression in 1933, might be more applicable to the attitude of the US investor today than at any other point in history.

Yet every objective indicator points to bubble valuations across multiple sectors and to the currency on the verge of a precipitous fall, given the prevailing *fiscal dominance*. What this implies is that US dollar-denominated investments (stocks, bonds, and real estate) are in for a rude awakening in the years ahead, and the Economy itself is headed for a depression that will make the 2008 GFC look like a *walk in the park*.

I. The Federal Reserve's De Facto Dual Mandate – The Arsonist and the Fireman.

Let us start with the Federal Reserve, the engine of Monetary Inflation, a necessary condition for the formation of asset bubbles. Jim Grant popularized the *arsonist-and-fireman analogy*, explaining how the Fed ignites bubbles through prolonged artificially low interest rates. When the bubbles eventually meet the pin, the Fed again rushes in with easing – much like the arsonist calling the fire department. We have seen this cycle repeatedly over the last 35 years.

- i. The easing cycle during the early 1990s, leading to the NASDAQ/dotcom bubble.
- ii. Post the Nasdaq burst in March 2000, the Fed again rushed into lowering the interest rates to a then-unprecedented 1% causing the formation of the Housing Bubble 1.0.
- iii. Post the collapse of the Lehman Brothers in September 2008, the Fed lowered the interest rates to 0% and maintained them around that level for nearly 15 years. Interest rates have never been this low for this long in 4000 years of monetary history.



But interest rates are only part of the story in the current easing cycle. A much more potent form of monetary inflation has occurred through an increase in the Fed's balance sheet via Quantitative Easing (QE), through which the US Fed purchased US Treasuries and Mortgage-Backed Securities. The Fed's balance sheet, which was less than \$1 trillion at the time of the 2008 GFC, would rise more than 6-fold in the subsequent 18 years to more than \$6.5 trillion today.

The National debt has ballooned during this period as well, i.e., the accumulated US National debt over more than 200 years leading up to 2008 was \$10 trillion, while in the subsequent 18 years, the debt has nearly quadrupled to \$39 trillion. If the BBB (Big Beautiful Bill) is indicative, we will witness the National Debt cross \$50 trillion before Trump's second term ends in 2028, even without a significant economic crisis.

This combination of reckless fiscal spending, aided by an ever-accommodative monetary policy, has fomented multiple bubbles that dwarf those of the past. All bubbles, eventually, find their pins, and given the enormity of the bubbles today, a tiny prick is all that would be required. The dominoes are lined up.

But before proceeding on to the “bubbles”, some questions ought to be asked and answered. We can clearly see the Boom-Bust pattern repeatedly playing out over the last 35 years in the figure above. Surely there must be sound theoretical explanations and ways to prevent these wild swings in economic activity. Why is it that there is a sudden rush to invest in a technology or in a specific asset class amongst a majority of the investing class?

The ***Misesian Theory of the Business Cycle*** accounts for all of the above questions and more (as explained in the book “*The Theory of Money and Credit*”). Rothbard’s essay “[*Economic Depressions: Their Cause and Cure*](#)” provides a succinct note of the relevant concepts. Given below is a two-paragraph summary of the Business Cycle Theory. For those not unduly interested in the economic theory, please feel free to skip to the next section.

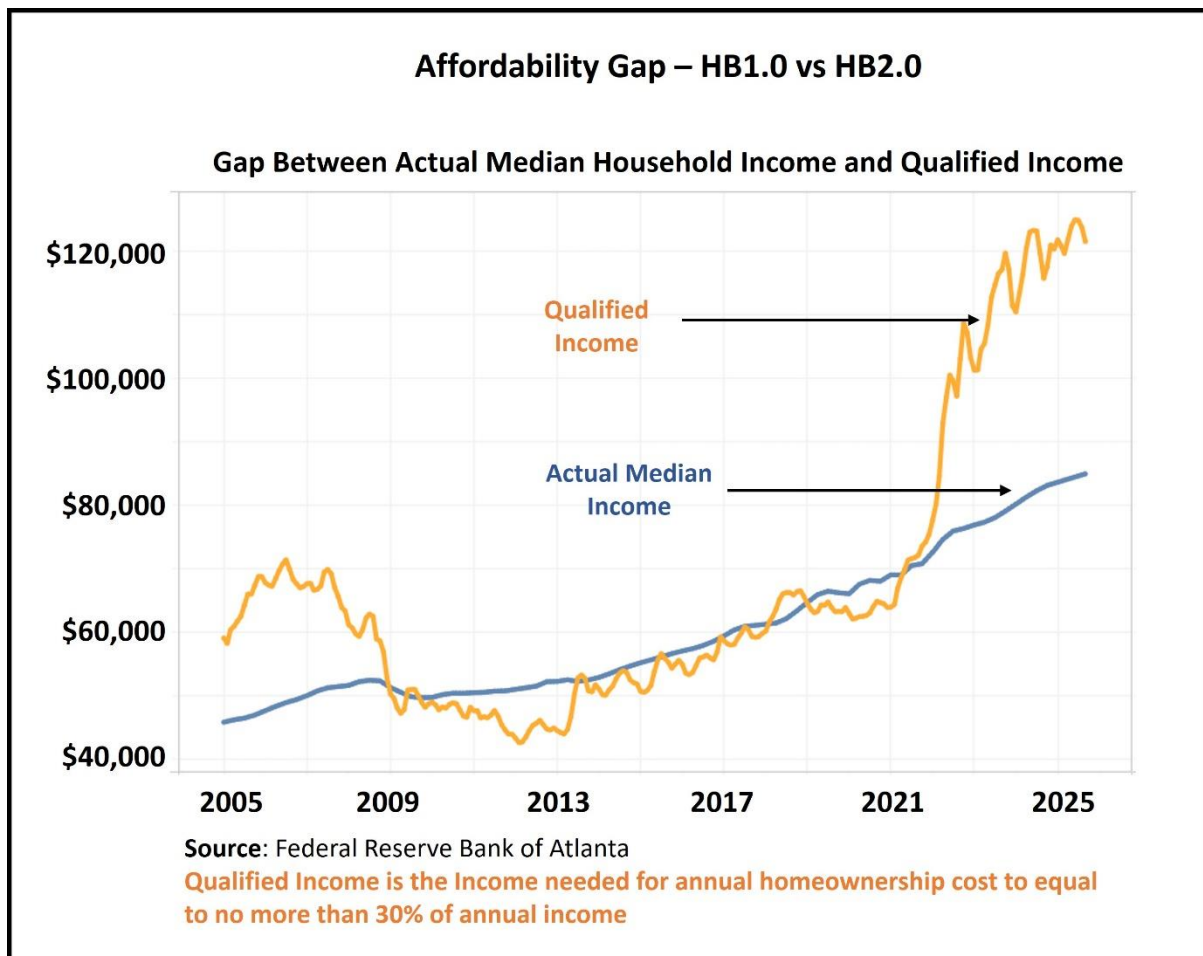
When a central bank artificially sets a low interest rate below the market rate (as determined by the confluence of the supply curve for savings and the demand curve for borrowing), it creates an illusion of greater savings. This ensures that marginal projects are brought online that would otherwise not be funded. However, given that the savings were an illusion, the market demand for the products created by these marginal projects is not forthcoming. Hence, these (mal)investments have to be liquidated.

The correct course of action for the government at this stage would be to stand by and allow the markets to clear the excesses of malinvestments. However, as we have seen repeatedly, a new wave of money/credit is created that furthers the current malinvestments or worse, create new ones. The process continues until we reach the stage of the Crack-Up Boom, or, more commonly, hyperinflation.

II. Bubbles Meeting the Pin of Economic Reality

Bubbles are created when excessive money and credit are directed to specific sectors of the economy. Given the enormity of the new money and credit that has been created since the 2008 GFC as explained in the previous section, the US is now floating on a sea of asset bubbles – HB2.0, AI Bubble, and the Bond Bubble.

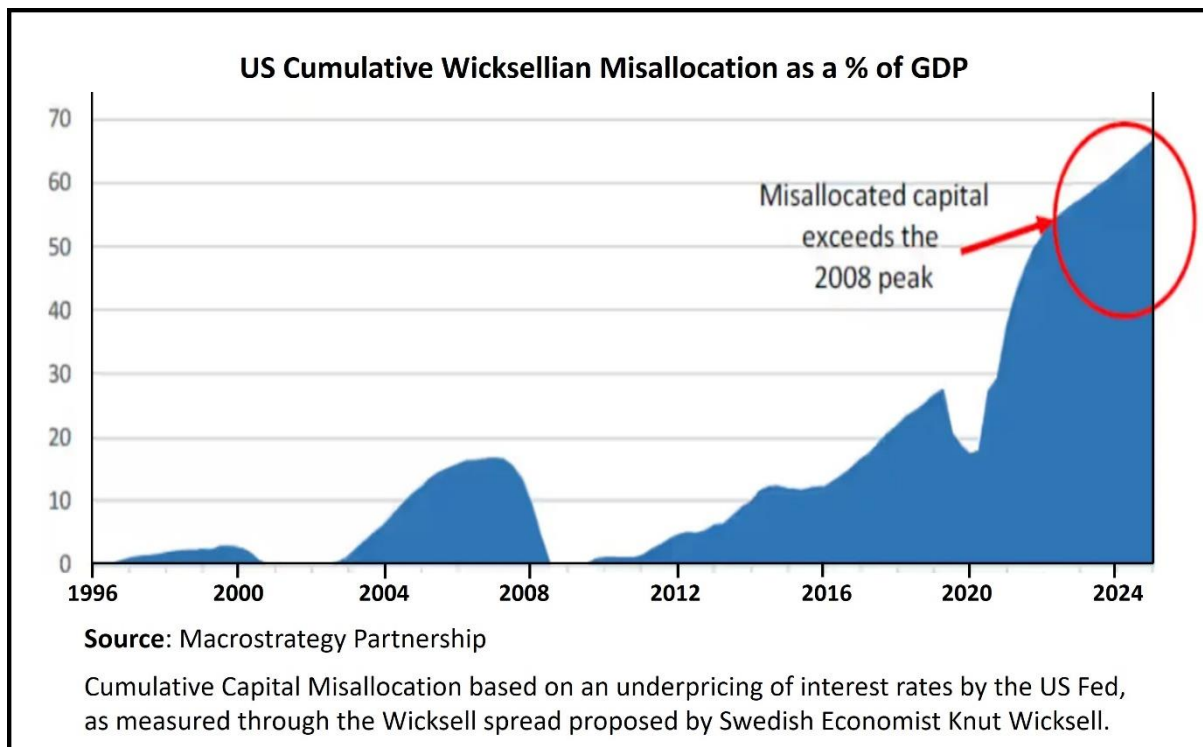
i. Housing Bubble 2.0



Several factors can explain why HB2.0 is much larger than HB1.0 of 2008. Some typical ones include median housing prices, inflation-adjusted housing prices, mortgage payments as a function of household income, etc. But the one Index that accounts for all factors, including home prices, household income, interest rates, taxes, and insurance, etc, is the Home Affordability Index (HAI). A modified version of the HAI is presented above to indicate that housing prices need to decline by more than 33% for affordability to return.

The fact that two other bubbles accompany the HB2.0 makes it nearly inconceivable that a solution could arise in the form of ZIRP and QE as happened after the 2008 GFC. Therefore, median prices will drop well below the levels indicated by median income. Ultimately, we should not be surprised by a 50% drop in housing prices when the HB2.0 bursts.

ii. AI Bubble

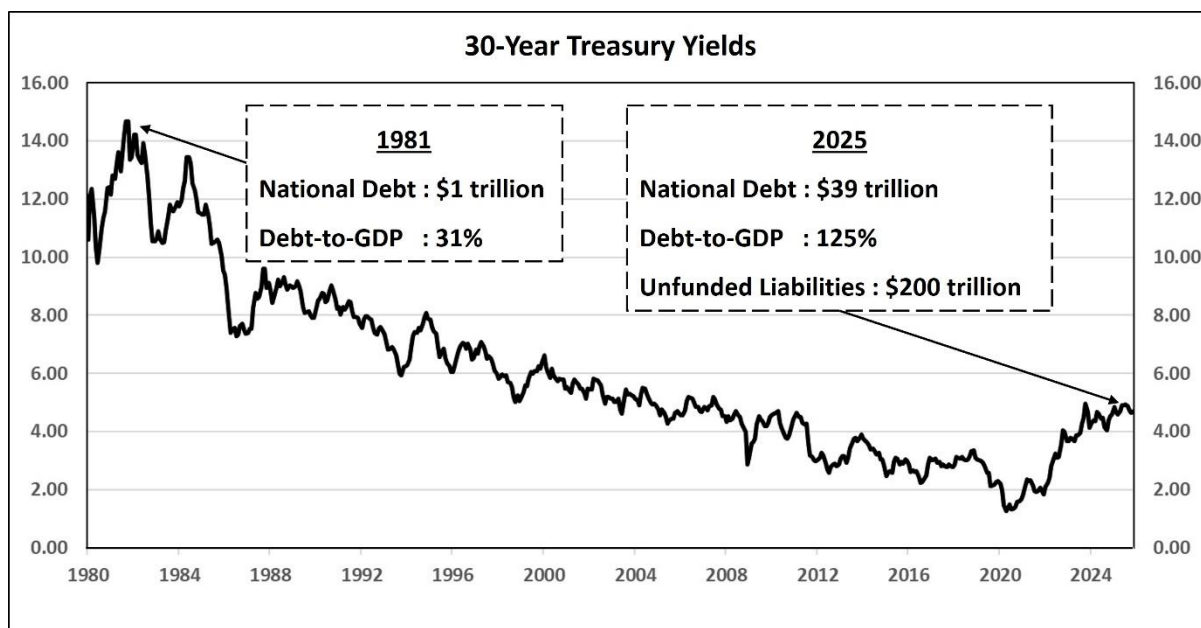


Any number of indicators can be used to indicate the AI bubble – MAG7 M.Cap to GDP ratio, Top 5 stocks today to Top 5 in 2000 as a % of S&P 500, Marginal AI Capex as a % of GDP growth, the circular vendor financing within the AI circuit etc.

The indicator that captures the total misallocation – AI, cryptos, NFTs, housing etc indicates a level of capital misallocation that far surpasses the 2008 GFC. In fact, the misallocation during the dotcom days appears like a rounding error compared to the total misallocation today. Investments in LLMs and Data Centres are soon going to look for a “Return Of Capital” let alone Return On Capital.

iii. The BOND Bubble

Despite the massive overvaluations, there is at least something to show for the money sunk into housing and AI. Investments in long-term treasury bonds, in comparison, are just paying US dollars today to receive pieces of paper two or three decades down the line. With an overwhelming probability, 30-year bonds are likely to become confetti if held to maturity – perhaps even a whole lot sooner than that.



If you think of the US as a company, it had revenues of \$5.2 trillion and an operating loss of \$2 trillion in 2025. If this company had debt of nearly \$40 trillion and other off-balance-sheet liabilities of \$200 trillion, what would its bond rating be?

JUNK wouldn't come close to describing the situation, with the only difference being that the government has a printing press to create dollar bills (digitally these days) out of thin air and hand them to creditors. But the question is, "What would the dollar's purchasing power be under these circumstances?" Perhaps very close to those of confetti.

The 30-year Treasury today would have to be the mother of all bubbles, given the sheer size of the market and the brazenness of rating agencies in looking past the fundamentals. And as it unwinds over the next few years, with interest rates increasing amidst a severe recession caused by the bursting of the AI and HB2.0 bubbles, the consequences are indeed unfathomable at this juncture.

Looking Ahead into 2026

Looking just ahead, and what is almost certain is that the first two bubbles – the HB2.0 and the AI bubble are going to burst one after the other. For the first time in more than 45 years, the US Government and the Federal Reserve are going to realize in no uncertain terms that it can only print its way into trouble, not print its way out.

Despite the similarities to the 2008 GFC, the key difference is that 2008 was a liquidity crisis while 2026 is going to be a solvency crisis. The consequence is that the US Dollar will rapidly lose value not only against gold but also against a majority of its trading partners.

The depression would be prolonged, and it stands to reason that the depth of the correction would be proportional to the inflationary boom during the preceding period. We have also seen that the monetary inflation after the 2008 GFC has not only been quantitatively much higher, but also, on a qualitative basis, reckless (“unconventional” would be the term the mainstream media would use). This depression is going to be one for the record books as the GDP contraction is going to rival the Great Depression.

Can anything be done at all at this point? At the outset, we should recognize that the recession is the cure to clear the malinvestments of the artificial boom. The problem we face is monetary inflation, which leads to the formation of bubbles. Let me quote from Rothbard’s essay on the correct way to handle a recession/ depression.

REPRINTED FROM ROTHBARD’S ESSAY “Economic Depressions: Their Cause and Cure”

What is the governmental role in the cure of depression?

In the first place, government must cease inflating as soon as possible. It is true that this will, inevitably, bring the inflationary boom abruptly to an end, and commence the inevitable recession or depression. But the longer the government waits for this, the worse the necessary readjustments will have to be. The sooner the depression-readjustment is gotten over with, the better. This means, also, that the government must never try to prop up unsound business situation;

....

Thus, what the government should do, according to the Misesian analysis of the depression, is absolutely nothing. It should, from the point of view of economic health and ending the depression as quickly as possible, maintain a strict hands-off, “laissez-faire” policy. Anything it does will delay and obstruct the adjustment process of the market; the less it does, the more rapidly will the market adjustment process do its work, and sound economic recovery ensue.

But did the US Government not solve the 2000 and the 2008 recessions by doing exactly the opposite? Not exactly “solve”, but managed to postpone the consequences by inflating bigger bubbles. But this has come at an enormous cost to the US Dollar. Gold that traded at \$250/oz in 2000 is now more than \$ 4,200/oz, indicating a more than 95% decline in purchasing power over this short 25-year period.

Any attempt at a reflation this time around would be the equivalent of throwing gasoline on a raging inferno. But one can almost certainly bet on the US Government in doing the one thing that it should not attempt.

Are we looking at a Weimar replay, perhaps by the end of this decade? Possibly... maybe even probably.

What about the rest of the World? This is where it gets interesting. The conventional (keynesian) economic thinking is that it is the US borrowing and consumption that keeps the rest of the world going. The truth is the opposite – it is always savings and production that drive economic growth. The rest of the world will hopefully conclude that the US is “too big to be bailed out,” and it is best to allow the dollar and the US economy to sink. The world would be better off without the US draining the savings of the world, importing the manufactured goods and exporting its monetary inflation. Not to mention the second export of military adventurism. Any country or currency that tethers itself to the US is going to sink with the Titanic.

That said, most countries face the same issues that afflict the US, i.e., large fiscal deficits, central bank monetization of deficits, and government infringement on civil rights and privacy – the list is almost endless. The US is the epicentre of the problems, primarily because of the US dollar's status as a reserve currency. However, all countries would face a currency issue, albeit to a lesser degree than the US. The solution for the other countries would be much the same – balanced budgets, sound money, deregulation and decentralization, and individual liberty.

About the Author

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